

THE RUSSIAN SPIN ON THE *YUKOS* DECISION

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On July 18, 2014, the arbitrators (Tribunal) at the Permanent Court of Arbitration in The Hague rendered a final award of \$51,600,000,000 to claimants, former shareholders of Yukos Universal Limited (Yukos), against the Russian Federation (Russia) as damages for Russia's actions that rendered Yukos bankrupt.

I. THE RUSSIAN ARGUMENTS

Initially, Russia argued that the arbitrators had no jurisdiction to hear this matter. The Tribunal deemed Russia's assertions groundless and dismissed them. Russia argued that it properly assessed taxes and fines against Yukos, that the claimants were arguing about Russia's lawful activity in collecting the taxes and fines, and that Russia was not responsible for Yukos' bankruptcy. However, the Tribunal concluded that Russia's conduct was not driven by the genuine exercise of its tax power and was not covered by any treaty exemption precluding an action against Russia for collecting taxes and fines.¹

Russia asserted that, under Russian law, each action was proper and should be viewed separately.² However, the Tribunal concluded that Russia's efforts must be considered together and constitute gross abuses. Furthermore, Russian law is not pertinent to the determinations of the Tribunal. The Tribunal operates under international law, and under its auspices, Russia's actions must be viewed as a series of related steps. Thus Russia was found to have expropriated the assets of Yukos while also seeking to remove Mikhail Khadorvsky from the political scene, which combined to deprive the claimants of the value of their investment in Yukos.³ In

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¹ Final Award, par. 65.

² Final Award, par. 70.

³ Final Award, par. 68.

reaching its conclusions, the Tribunal determined that the treatment of senior executives of Yukos, mid-level employees, in-house counsel, external lawyers and related entities demonstrated that the Russian authorities were conducting “a ruthless campaign to destroy Yukos, appropriate its assets and eliminate Mr. Khadorvsky as a political opponent.”⁴ The arbitrators stated that they were convinced that intimidation and harassment of those individuals not only disrupted the operations of Yukos but also contributed to its demise and thereby damaged claimant’s investment.⁵

II. THE TRIBUNAL’S RESPONSE

The Tribunal found that Russia was responsible for its actions by acting through the highest officers of Rosneft, a state owned entity which acquired Yukos’s assets, and that senior Rosneft officers were also officers of the State working with the President of Russia, Vladimir Putin, to effect the expropriation of Yukos’ assets.⁶ Moreover, Russia’s conduct and the conduct of Rosneft were coordinated to drive Yukos into bankruptcy.⁷ The arbitrators concluded that Russia’s State apparatus caused Yukos to go bankrupt, resulting in an appropriation of its assets to the state or state appointed designee. Russia also used the state apparatus to remove Khadorvsky.⁸ The “tax assessments, and the enforcement processes of the Russian Federation which followed, are more consistent with the conclusion that they evidence a punitive campaign against Yukos and its principal beneficial owners with sanctions entirely disproportionate to the company’s tax liability, rather than with the conclusion that they were a legitimate exercise of tax enforcement.”⁹

Ultimately, the arbitrators determined that the Yukos bankruptcy proceedings were not simply to collect taxes and fines but were “the final act of the destruction of the Company by the Russian Federation and the expropriation of its assets for the sole benefit of the Russian state and state owned companies, Rosneft and Gazprom.”¹⁰

⁴ Final Award, par. 811.

⁵ Final Award, par. 820.

⁶ Final Award, par. 1480.

⁷ Final Award, par. 1146, 1148.

⁸ Final Award, par. 510.

⁹ Final Award, par. 514.

¹⁰ Final Award, par. 1180.

III. THE RUSSIAN RESPONSE

Immediately after the award was made public, Russian representatives reacted predictably, as it had done in prior cases of unfavorable judgments. A spokesman for Russia's Finance Ministry, describing the arbitration award as "flawed," "one-sided" and "politically biased," asserted that Russia would appeal the decision.¹¹ On its website, Russia's Finance Ministry said that it would appeal the ruling in the Dutch courts, criticizing what it termed a "politically biased" judgment which had "serious flaws" while characterizing the damages as "unprecedented."¹²

Sergei Lavrov, Russia's Foreign Minister, said the country would "use all possible legal means to defend their position."¹³ Lavrov stated, "The agencies which represent Russia in this process will no doubt use all available legal avenues to defend its position."¹⁴ After the award was announced, Russia's Finance Ministry said the court "had no jurisdiction to consider the questions it was given," noting also that the finding was "politically motivated."¹⁵

Vladimir Pligin, described as head of the Constitutional Affairs Committee of the lower house of the Russian Parliament, said that the ruling by the Tribunal was "yet another form of sanctions against Russia," and "these measures against our company are unacceptable."¹⁶

IV. FUTURE ACTIONS

It is not clear to which court or courts Russia will appeal. The award at The Hague is "final and binding." Furthermore, there are no apparent grounds for a Russian appeal. Nevertheless, familiarity with the Russian approach to arbitration means that the likelihood of one or more appeals borders on certainty. History teaches that the

¹¹ <http://beavercountian.com/content/guardian-international/russia-ordered-pay-50bn-damages-yukos-shareholders>.

¹² <http://www.bloomberg.com/news/print/2014-07-28/yukos-owners-win-50-billion-damage->

¹³ <http://beavercountian.com/content/guardian-international/russia-ordered-pay-50bn-damages-yukos-shareholders>

¹⁴ Russia set to appeal \$50 bn Yukos ruling, bne, July, 29, 2014, Russia daily newsletter.

¹⁵ *Id.*

¹⁶ <http://www.bloomberg.com/news/print/2014-07-28/yukos-owners-win-50-billion-damage->

Russians will attempt to re-litigate this matter. Commentators have observed that the appeal process could go on for years.

The award states that Russia has until January 15, 2015 to pay up. Thereafter, the claimants are able to pursue Russia's international assets. Not surprisingly, the Russians have not paid. If the victorious claimants go after Russia's international assets, Rosneft, the Russian state-owned oil firm is a likely target as is Gazprom. Claimants' attempts to enforce collection of the award abroad are likely to be challenged by the Russians.

When the award was announced, Rosneft said that it was not a party to the litigation and that it did not expect to be affected by it.¹⁷ Rosneft added, "Rosneft believes that all the deals to purchase former assets of Yukos as well as all its actions regarding Yukos were fully legitimate and were done in line to the legislation at the time."¹⁸ This may provide a basis on which Russia will object to the validity and collectability of the claim by asserting that all Russian legislation was satisfied by Rosneft.

Yukos will not be the first arbitration in which Russia will have challenged prior adverse awards. An examination of several prior adverse decisions and the Russian response gives insight into the future course of action by Russia.

V. SEDELMAYER'S ACTIONS AGAINST RUSSIA AND RUSSIA'S RESPONSE

Sedelmayer v. Russian Federation was the first major investment treaty arbitration to produce an award against Russia. In 1991, Franz J. Sedelmayer's company entered into a joint venture with the Leningrad police department. In late 1994, Russia ordered the premises repossessed by its government. Sedelmayer abandoned the facilities and left St. Petersburg (previously named Leningrad under the Soviets) on short notice, leaving vehicles and other personal effects behind.¹⁹

¹⁷ [http://www.thehindu.com/news/international/world/permanent-court-for-arbitration-in-the-hague-netherlands-orders-russia-to-pay-50-billion-to-former-yukos-shar/...](http://www.thehindu.com/news/international/world/permanent-court-for-arbitration-in-the-hague-netherlands-orders-russia-to-pay-50-billion-to-former-yukos-shar/)

¹⁸ *Id.*

¹⁹ Investment Treaties and the Russian Federation: Baiting the Bear? By Noah Rubins and Azizjon Nazarov, *Business Law Journal*, V. 9, No. 2, May, 2008, p. 106.

In 1995, Sedelmayer submitted a claim for arbitration under the German-Russian BIT Treaty of 1989 at the Arbitration Institute of the Stockholm Chamber of Commerce.²⁰ One of Russia's main arguments offered at the arbitration proceedings was that Russia was not a proper party to the arbitration because the Leningrad Police Department was the entity that signed the contract with Sedelmayer. Despite Russia's opposition, in 1998, Sedelmayer obtained a favorable arbitration award of \$2.350 million. Russian failed to pay voluntarily.²¹

Because Russia refused to pay him, Sedelmayer sought to enforce the award by seizing Russia's assets abroad. In Germany he tried to assert his rights to payments from German airlines to Russia for use of German airspace. A German court held the Russian assets immune from attachment by Sedelmayer.²² Sedelmayer also attempted to seize the Roscosmos Russian aircraft exhibit at the 2006 ILA Airshow in Berlin. *Kommersant* notes that the private security personnel held off the bailiffs.²³

In Cologne, Germany, Sedelmayer overcame Russia's opposition to enforcement by attaching the Soviet Trade Office. A German court ruled that the office building was not used for official Russian business and was not immune from enforcement.²⁴ Sedelmayer prevailed. That complex is now rented by the city of Cologne and used to house refugees. Russia appealed the decision and transferred ownership of the property to a state enterprise; however, the Higher Regional Court in Cologne ruled again in favor of Sedelmayer.²⁵ In March, 2008, a court in Cologne ruled that the complex could be auctioned off with the proceeds going to Sedelmayer. Observers have noted that Sedelmayer's success might lead to more suits against Russia.²⁶

On July 1, 2011, the Supreme Court of Sweden refused to apply sovereign immunity protection to the trade mission of the Russian

²⁰ *Id.*

²¹ <http://www.cisarbitration.com/2011/07/13/chasing-the-russian-federation/>

²² *Id.*

²³ http://www.kommersant.com/p.868296/r_500/international_commercial_law.

²⁴ <http://www.cisarbitration.com/2011/07/13/chasing-the-russian-federation/>.

²⁵ http://www.kommersant.com/p.868296/r_500/international_commercial_law.

²⁶ *Id.*

Federation.²⁷ That decision may be the first case in which a part of a building currently used by Russia as a trade mission was declared not protected by immunity. The rationale for the conclusion lay in the action by the Russian Federation which rented units to individuals and companies that were not working for the trade mission.²⁸

The Russian Ministry of Foreign Affairs challenged the validity of the Swedish judgment. Russia asserted that the Swedish Court had violated the Vienna Convention on Diplomatic Relations because the property was immune and Swedish authorities purportedly failed to explain Sweden's international obligations. The Swedish Ministry of Foreign Affairs responded that the courts of Sweden were independent.²⁹

In 2011 CIS Arbitration Forum described the Sedelmayer case as demonstrating “that while the system of investor-state arbitration helps to overcome sovereignty immunity from resolving merits of the dispute, it does little to empower investors to actually enforce the arbitration award.”³⁰

As of June 18, 2012, Sedelmayer had won an award for damages in the arbitration and subsequently enforced the award in Germany by seizing real estate previously used by the KGB.³¹ Peter Bert's blog, also dated June 18, 2012 reported that Russia was apparently planning to protect its enterprises and citizens from interference by foreign courts and arbitration tribunals. At the St. Petersburg Legal Forum, Anton Ivanov, Russia's senior most commercial judge, gave a speech the previous month, using the Sedelmayer judgment as an example, to declare that there was “unfair competition” from foreign courts and arbitration institutions and disregard of Russian sovereignty.³²

VI. NOGA

A predecessor to Sedelmayer was NOGA. NOGA and the Russian Federation entered into contracts in 1991 and 1992 under which NOGA was to provide the Russian Federation with foodstuffs and

²⁷ <http://www.cisarbitration.com/2011/07/13/chasing-the-russian-federation/>

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.*

³¹ <http://www.disputeresolutiongermany.com/2012/06/from-russia-with-love-foreign-courts-arbitration-and-protectionism-at-the-st-petersburg-international-legal-fo>.

³² *Id.*

consumer goods to be paid for by the sale of Russian oil.³³ The agreements provided for the arbitration of disputes under Stockholm Chamber of Commerce provisions.³⁴ In the agreements, the Russian Federation waived its property immunity and recognized the jurisdiction of the Stockholm International Arbitration Court.³⁵ Following the 1993 default by the Russian Federation, NOGA initiated arbitration and won a \$63 million arbitration award with interest in 1997. The award authorized NOGA to attach Russian Federation assets.³⁶

The Russian Federation appealed for an annulment of the award. The Swedish Courts dismissed the appeal. NOGA then sought enforcement in various international courts.³⁷ In 2000 a judgment “at the Paris County Court ordered the attachment of all Russian diplomatic assets in Paris.”³⁸ Also in 2000, NOGA sought to confirm and enforce the Swedish arbitration award in the United States.³⁹ The Russian Federation opposed confirmation, arguing that it was not a party to the arbitration agreement or to the Swedish arbitration proceedings.⁴⁰ Russia argued that the proper party was the Government of the Russian Federation, the political organization of the Russian central government.⁴¹ A United States District Court agreed with the RSFSR. In 2004, the Second Circuit reversed the District Court’s holding stating that, even under Russian law, “Plainly in light of the description of the Government in the Russian Charter, that entity is not a sovereign, corporation or instrumentality separate from the Russian Federation. Rather, the Government is a political organ of the Russian Federation, analogous to the cabinet of the American president” (361F 3d 676, 2004). However, the court remanded to the District Court on the issue whether NOGA’s

³³ <http://www.internationallawoffice.com/newsletters/detail.aspx?g=4e9d423b-39cf-41dc-93b3-1e1cb5fccdb3>.

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Compagnie Noga D’Importation et D’Exportation S.A. v. The Russian Federation*, 361F.3d 676/(March 16, 2004); <https://law.resource.org/pub/us/case/reporter/F3/361/361.F3d,676.02-9272.02-9237.html>

⁴⁰ *Id.*

⁴¹ *Id.*

assignments of its arbitration proceeds to certain creditors deprived it of standing to seek confirmation of the arbitration award.⁴²

In 2000-1, NOGA was temporarily successful in attaching assets of the Russian Federation in France including assets of: the Russian Embassy, the Central Bank of Russia, the Russian Mission to UNESCO, Vnechekonobank and Vneshtorybank and the Ship Sedov (owned by the University of Murmansk).⁴³

On June 22, 2001, NOGA attempted to attach two Russian airplanes at the Le Bourget Airshow. That effort was unsuccessful only because the planes left France in time to avoid attachment. In 2002, after Nessim Gaon's (the owner of NOGA) lawyer threatened to seize President Putin's airplane when Putin was in Paris, the Russians reconvened negotiations with NOGA.⁴⁴

In November, 2005, 54 paintings from the Pushkin State Museum of Fine Arts being exhibited in Switzerland were "arrested" on order of the Geneva Bureau of Debts, Claims and Bankruptcy. The "arrest" was subsequently lifted.⁴⁵ Later in November, 2005, truckloads of those paintings, insured for \$1 billion, were "arrested" again but re-released.⁴⁶

In 2005-6, Alexander Kogan, president of IPD Capital in St. Louis, "acting with the knowledge of Russia's Foreign Ministry" negotiated to purchase \$70 million of debt owed by NOGA to three of its banks. That transaction left Nessim Gaon, owner of NOGA, "without the backing of major financial organizations" in pursuing NOGA's claims. The Moscow Times describes Kogan as saying that an "official document would have to be obtained from the international arbitration court in Stockholm to the effect that NOGA had no more claims against Russia."⁴⁷

Doggedly, NOGA obtained a ruling in 2008 from the Swiss Supreme Court in Lausanne that three Russian central bank accounts

⁴² *Id.*

⁴³ <http://www.international/lawoffice.com/newsletters/detail.aspx?g=4egd423b-39cf-41dc-93b3-1e1cb5fccdb3>.

⁴⁴ http://www.kommersant.com/p627106r_1/Noga_s_Arrest_a_No_Go/

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ <http://www.themoscowtimes.com/business/article/us-businessman-buys-70m-noga-debt/206362.html>.

at three Swiss banks should be arrested. Gaon commented “The Russian Government must pay, they have kept us waiting for 14 years.”⁴⁸ That comment occurred, in France several weeks earlier, followed closely by the freezing of accounts of Russia’s Central Bank and News Agency, RIA Novosti, to secure repayment of debts owed by Russia to NOGA. At the same time, Kogan stated that, in 2006, he had repurchased Russia’s debt from NOGA’s four creditor banks and transferred that debt to Russia. Russia’s lawyers stated that NOGA had ceded its claims to the banks and no longer had any right to the claims under the arbitration ruling.⁴⁹

On September 22, 2009, the United States Court of Appeals for the Second Circuit, affirming the opinion of the District Court, held that “NOGA failed to establish that it retains an interest in the arbitral award” and had no standing to seek confirmation of the award. That was 12 years after the initial granting of the award to NOGA.⁵⁰ It is of interest to note that the United States had changed its policy toward Russia in the interim, and it is impossible to ascertain how that political agenda of reset may have affected the decision.

VII. PREDICTIONS

Based on recent past history, it is safe to predict that Russia will continue to refuse to pay the \$51,600,000,000 award to Yukos claimants. Now that Russia has confiscated Yukos’s assets, albeit illegally, Russia will try to circumvent enforcement. An old Russian proverb says, “хорошо заплатить деньгами других людей” [translation: It is good to pay with other people's money.] At present, the new Russia invokes this wisdom and enjoys using expropriated Yukos revenue to meet its own obligations. Even the 3% decline in Russian stocks that occurred immediately after the announcement of the Tribunal’s findings has not swayed Russia to honor its obligations. Investors in Russian companies can expect that the Russians will use many courts to try to nullify adverse arbitrators’ decrees and will also argue that attempts to collect are politically motivated sanctions. Yukos claimants have a lengthy battle ahead but also have the power and authority of international law on their side. Yogi Berra’s comment, “It ain’t over ‘til it’s over,” captures the Russian attitude toward unfavorable court decisions.

⁴⁸ <http://en.ria.ru/business/20080124/97687528.html>.

⁴⁹ *Id.*

⁵⁰ http://www.cgsh.com/russian_federation_wins_appeal/.

